



MULTISTATE TAX COMMISSION

To: Uniformity Committee
Tommy Hoyt, Chair

From: Standing Subcommittee
Maria Sanders, Chair

Subject: Recommendations on Proposed Partnership Project (as adopted)

Date: March 18, 2021

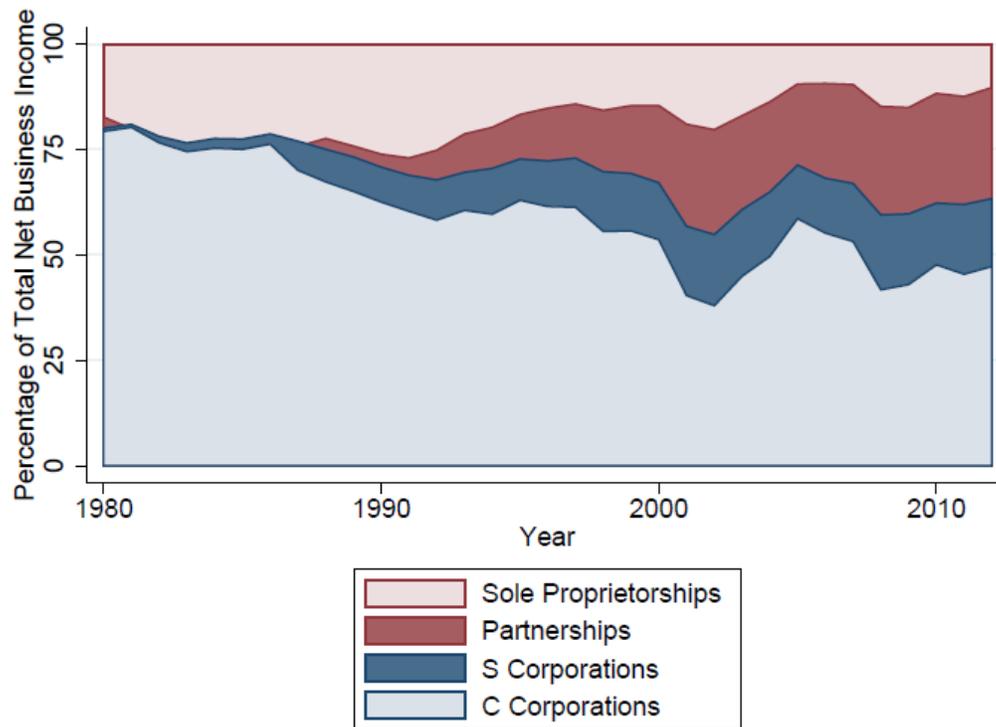
The Uniformity Committee asked the Standing Subcommittee to consider, in accordance with its general criteria, a proposed project to study and make recommendations to states concerning the taxation of partnership income.

DOES THE PROPOSED PROJECT FIT THE GENERAL CRITERIA FOR A UNIFORMITY COMMITTEE PROJECT?

Among the criteria generally used to evaluate new projects are the following:

- Does the project fall within the Commission's general expertise and mission, that is, state taxes on multistate businesses and related issues?
- Would it build on existing models or work done previously?
- Is it a pervasive issue affecting a number of states or taxpayers?
- Would the project produce a model law to address an emerging issue?
- Would the project produce a uniform law, and if so, how difficult it would be for states to change any existing laws?
- Would the goals of the project require legislation or could be accomplished by agency action?
- And would there likely be political support or opposition?

The project fits well within the Commission's general expertise in that it focusses on partnership businesses and the sourcing of multistate partnership income. While partnership taxation is complex, we believe we have sufficient expertise to draw on within the participating states. The project would also build on information developed in the committee's previous Partnership/RAR project—which addressed how states will assess tax on federal adjustments from centralized partnership audits. In addition, partnership taxation is growing in importance, as the graph below demonstrates.



See “Business in the United States: Who Owns It and How Much Tax do They Pay?,” U.S. Dep’t of Treas., Office of Tax Analysis, Working Paper 104, p. 31, October 2015, available on the MTC website, here: <https://www.mtc.gov/getattachment/Uniformity/Project-Teams/Partnership-Informational-Project/OTA-Business-in-the-United-States.pdf.aspx>

The project might produce a model or uniform law—or it might point to existing state laws and regulations that represent best practices. In many cases, states lack a fully developed set of partnership tax rules, and so, as states look to build out those rules, this information would be helpful. Some of the changes may or may not require legislation—but given that there appears to be a developing consensus on a number of issues, there no reason to expect concerted political opposition to clarifying those issues.

Moreover, partnership income may be taxable to either corporate or individual taxpayers. Therefore, even the states that do not tax individual income, but do tax corporate income, would potentially benefit from the project. One open question is to what extent the project would address state taxes that are imposed at the entity, rather than the partner, level.



ANALYSIS OF THE ISSUES

The Standing Subcommittee has developed a working draft of an issue paper—which gives background information on partnership taxation and on the critical issues that states need to address. (See the latest draft of this issue paper on the Standing Subcommittee web page, here:

<https://www.mtc.gov/getattachment/Uniformity/Project-Teams/Partnership-Tax/Partnership-Issue-Outline-March-2020.pdf.aspx?lang=en-US>.) That report contains a summary of the main issues as well as some preliminary analysis of the general state positions on these issues and where these positions are likely to vary.

Based on this preliminary analysis, it appears there is a need for additional study and evaluation of the issues, and it also appears that states would benefit from understanding the implications of the different state approaches that are currently used.

PROPOSED SCOPE OF THE PROJECT

APPROACH

The Standing Subcommittee proposes that, in general, the Committee establish a work group with representatives from interested states to hold regular meetings to consider the issues as outlined, including other related issues, as well as the different state rules, and to determine whether a particular rule or approach constitutes a best practice—or what the pros and cons might be from embracing a particular approach. The work group would then present its findings to the committee, which would decide whether to undertake the drafting of any model or uniform statutory or regulatory provisions. The Standing Subcommittee believes that the exercise would be instructive whether or not model or uniform statutory/regulatory provisions are proposed.

ISSUES GENERALLY

The Standing Subcommittee proposes that the following general issues be addressed (as more fully outlined in the draft discussion paper):

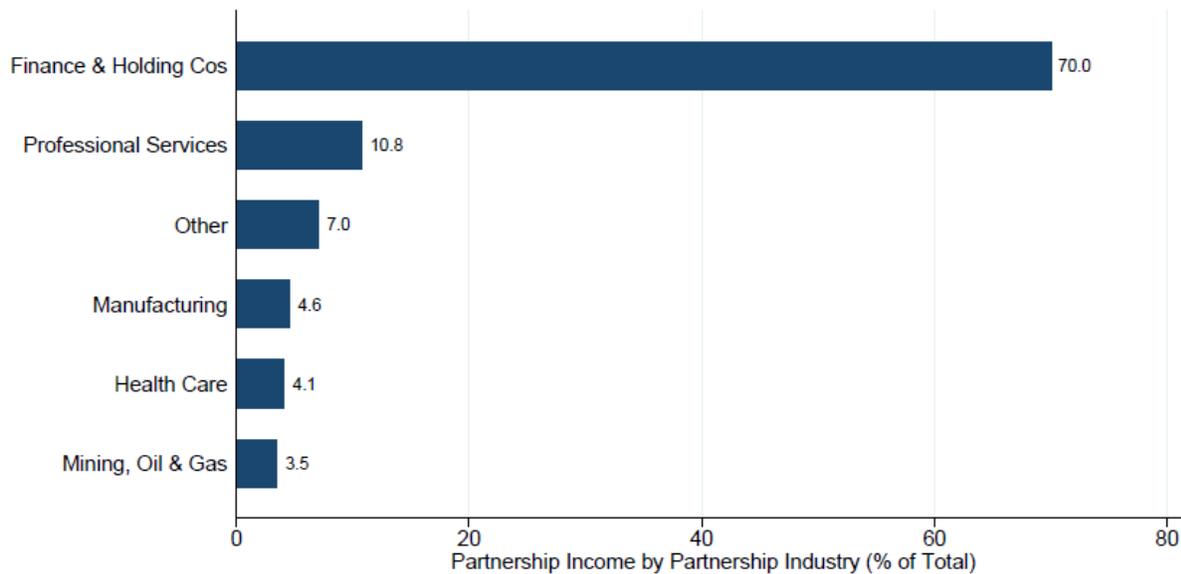
1. Partnership – Operating Income – Generally – Pass-Through Treatment
 - a. Jurisdiction or Nexus over Out-of-State Partnerships and Nonresident Partners and Related Issues
 - b. Sourcing of Income and Related Issues
 - c. Investment Partnerships



- d. International Issues (if any)

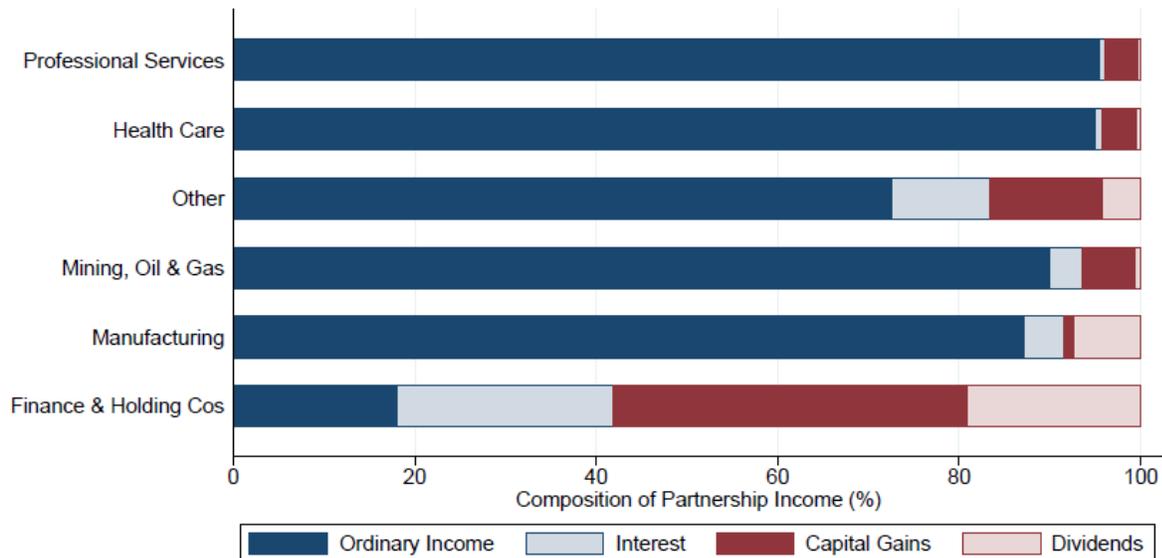
- 2. Sale of a Partnership Interest – Generally
 - a. Nexus over Nonresident Partners
 - b. Sourcing of Gain/Loss
 - c. Investment Partnerships
 - d. International Issues (if any)
- 3. Administrative and Other Issues
 - a. Credits for Taxes Paid
 - b. Information Reporting and Audits
- 4. Partnership Level Taxes - Generally

Note that the need to specifically address investment partnerships is highlighted by the following information on how partnership income, generally, breaks down by sector:



See “Business in the United States: Who Owns It and How Much Tax do They Pay?,” U.S. Dep’t of Treas., Office of Tax Analysis, Working Paper 104, October 2015, p. 34 available on the MTC website, here: <https://www.mtc.gov/getattachment/Uniformity/Project-Teams/Partnership-Informational-Project/OTA-Business-in-the-United-States.pdf.aspx>

Also, investment partnerships tend to have different types of income, as the following graph demonstrates:



See “Business in the United States: Who Owns It and How Much Tax do They Pay?,” U.S. Dep’t of Treas., Office of Tax Analysis, Working Paper 104, October 2015, p. 34 available on the MTC website, here: <https://www.mtc.gov/getattachment/Uniformity/Project-Teams/Partnership-Informational-Project/OTA-Business-in-the-United-States.pdf.aspx>

Note also that, with respect to international issues, the TCJA changed or clarified how foreign partners of domestic partnerships pay tax and how U.S. partners with foreign source income from foreign partnerships are treated. Understanding this recent federal law change might also be a worthwhile focus of the work group.

OTHER

In addition to establishing the work group, the Committee may consider having information and training sessions for the states on federal pass-through taxation, generally, to provide background or get the perspectives of experts in the field—including in such areas as changes in federal information reporting requirements, effects of the new centralized partnership audit regime, compliance problems, etc.



CONCLUSION

The Standing Subcommittee recommends that the Uniformity Committee take up a project on state partnership taxation as outlined above and create a work group to consider these subjects. The work group would evaluate the important issues and determine whether best practices exist, which would likely be of great value to the states, and report back to the committee. The work group would also make recommendations to the committee as to whether drafting uniform or model statutory or regulatory provisions might also be useful to the states.